dismal. For example, we have assumed that the operator is required to invest $24 million a year for the years 1995 to 1999 (the other assumptions are consistent with the base case). This analysis shows that over the 15-year franchise period, with the benchmark approach, the return on investment is negative.[47/] Clearly, in these circumstances, only a cost-of-service approach could allow a system to earn a reasonable return.

In Exhibit B, we analyzed franchise renewal with and without rebuild requirements but without benchmark regulation. The major difference here is that in the base case without regulation, rates can escalate at 6% per year, with all other assumptions remaining the same. The return on investment is still less than 9%.[48/] However, when adding in the same requirement for a rebuild, there is still a yield of less than 6% as a return on investment over the life of the system.[49/]

Other commenters have argued that merely having a positive cash flow demonstrates financial health. This, however, is a misconception; positive cash flow is the minimum requirement for business survival. Cash flow simply is the net difference between cash in-flows and out-flows.[50/] Firms can experience

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47/ Exhibit A at A-5.

48/ Exhibit B at B-2.

49/ Exhibit B at B-5.

50/ Specifically, net income plus non-cash expenses such as depreciation and amortization, less all cash expenses.

large financial losses and still maintain a positive cash flow. Exhibit C demonstrates how a typical cable company can lose money while maintaining a positive cash flow and pay no return to its investors.

A negative cash flow implies that a firm is not paying its bills or that it must borrow to remain in business. The firm is technically insolvent when operating with a negative cash flow for any length of time, and any creditors not being paid could force it into receivership. Many lending agreements require cash flow coverage ratios as a requirement or covenant prior to the commitment of any funds. These ratios require a firm to operate with a positive cash flow typically at a level of several times the required debt service, or become subject to default. In this situation even a positive cash flow, if insufficient as a multiple of the debt service, would threaten the viability of the enterprise. Accordingly, a positive cash flow is not a sign of a financially strong business, but a minimum indication of the viability of the business.

In our initial comments we also analyze the financials for Rifkin Acquisition Partners to demonstrate the effect of the benchmarks on the financial viability of the systems included.[51/] As set forth in Exhibit D, Table I shows the actual operating

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51/ Rifkin operates systems in Georgia, Tennessee, Michigan and Illinois.

data through the end of 1992 with projected (pre-reregulation) figures through the end of 1998. While the systems have been expanding to pass more homes, penetration has increased at slightly less than 1% per year, as exemplified by the trends nationally. Table II shows that net cash does not become positive until the fifth year of operation and that the accumulated net loss continues through the entire projection period, although it is being reduced after the third year. This demonstrates initial start-up losses as well as foregone future earnings, that have been the subject of discussion concerning "premiums" paid on acquisition.[52/]

Significantly, Table II does not reflect the capital expenditures as a cash out-flow, although these expenditures are necessary to maintain the system. These expenditures are only reflected in the changed interest expense to pay for the added debt necessary to support that cash out-flow. The net cash increases throughout this projection period of approximately $52 million are thus offset by approximately $40 million in capital expenditures, and an additional $12 million in debt retirement.

For a system with an express rebuild requirement, the situation is even more dramatic. As Table III indicates, the Georgia system, which has been rebuilt as of 1992, does not

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52/ See Joint Comments at 27-28.

become cash positive through the 1998 projections. The rebuild, along with other annual capital requirements, amounts to $26 million over the entire period. However, in that same period positive net cash is less than $15 million on an accumulated basis. Accordingly, the capital expenditures exceed net cash by $11 million and swallow up the existing indicated net "profit" of slightly more than $1 million shown for 1997 and 1998. Additional rate restrictions which do not reflect the reality of rebuild expenses will seriously jeopardize the continued viability of the system.

B. Inclusion of Intangibles In The Ratebase

Joint Commenters propose that the Commission take an approach to valuing cable systems newly entering regulation that will reflect the value of intangible assets because thos assets have been bought and paid for, or otherwise reflect capital committed by the original owners. Unlike other regulated industries, during the period in which there was no regulation, it cannot be said that past subscribers paid for this "going concern value" so as to justify its exclusion under the traditional utility cases.[53/] Moreover, cable companies are able to document and explain these startup losses and earnings deficiencies, so that the Commission will not be faced with the task of guessing

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53/ See, In The Matter of Amendment of Part 65, 7 F.C.C. Rcd. 296, 299 (1991)

at a particular addition to rate base. Finally, as recognized by one of the state regulators, it would be troubling to exclude acquisition premiums as they have been defined from the rate base in determining rate regulation.[54/]

The concept of including intangibles in the ratebase is justified as a transition measure under the theories of "fair value" and the implicit recognition that intangible assets have a value capable of, and deserving, a return to investors. Predictably, a number of the cable opponents in their initial comments have challenged "fair value"-type approaches and will likely do so in the replies.[55/] However, none of the valuation problems which led to the elimination of the "fair value" rule is present.[56/]

Other regulators have allowed deferred earnings to be recovered under the theory of "reinvested earnings". For

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54/ Comments of the Massachusetts Community Antenna and Television Commission, p. 7.

55/ See, e.g., BOC Joint Comments at 19; CFA Comments at 3-6; Comments of NATOA, et al. at 11.

56/ See Joint Comments at 55-57. One of the foremost criticisms of a "fair" or "market" valuation approach to valuing rate base is that the valuations were based on an earnings stream derived from the rates that the regulator was supposed to set. Accordingly, the valuation became the arbitrary extension of an existing rate. "Rates cannot be made to depend upon 'fair value' when the value of the ongoing enterprise depends on earning under whatever rates may be anticipated." FPC v. Natural Gas Pipeline, Co., 315 U.S. 575, 601 (1942).

example, a "reinvested earnings account" keeps track of earnings and investors in equally risky ventures would expect to receive in cash, but due to early losses, prevent investors from realizing.[57/] Because these "earnings" remain with the business instead of being taken out in cash, they effectively are reinvested, hence the account "reinvested earnings".[58/] These reinvested earnings "deserve a rate of return commensurate with the other cash invested in the business. And because they are earnings that in other circumstances could be taken out in cash, the [reinvested earnings account] must eventually be amortized and returned to investors."[59/] The Virginia State Corporation Commission agreed and found that the use of the reinvested earnings account was reasonable.[60/]

Moreover, the Supreme Court's subsequent decisions recognize that adopting a single theory of rate making as a constitutional requirement would unnecessarily foreclose viable alternatives, including fair value. "For example, a rigid requirement of the prudent investment rule would foreclose hybrid systems

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57/ See testimony of A. Lawrence Kolbe, on behalf of Toll Road Corporation of Virginia, Case No. PUA900013, Virginia Corp. Comm'n (July 6, 1990).

58/ Id. at 11.

59/ Id.

60/ Application of Toll Road Corporation of Virginia, Case No. PUA900013, Opinion and Final Order (Virginia Corp. Comm'n, July 6, 1990).

. . . it would also foreclose a return to some form of the fair value rule just as its practical problems may be diminishing."[61/] Similarly, other courts critical of the fair value rule recognized that the rule was grounded in the economics of the particular day.[62/] The economics of regulating cable today, however, more closely resemble the regulation of utilities in earlier years, before original cost became a viable method of determining ratebase investment. Moreover, the existence of intangibles -- to the extent they are reflected in a fair value calculation -- reflect the total cost of capital committed to the establishment and operation of the system. While these systems are maturing and adjusting to the rigors of regulation, the Commission should allow a return on all the invested capital, as well as amortization of the value of these intangible assets.

V. Original Cost

As set forth in the initial round of comments, an "original cost" calculation for ratebase would be impossible in most situations and not reflective of the total amounts invested in the operation of the system due to the early start-up losses and earnings deficiencies. Moreover, capital subsequently

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61/ Duquesne Light Co. v. Sanford, 488 U.S. 299, 316 n.10 (1989).

62/ Cf. Farmer's Union Cent. Exchange, Inc. v. F.E.R.C., 584 F.2d 408, 418 (D.C. Cir. 1978).

committed to increasing subscriber growth and penetration are not part of "tangible" plant equipment recorded on the asset side of the balance sheet. Because cable service is a combination of content and transport, relying solely on the "transport" cases (such as telcos) would be unreasonable. Now, given the devotion of cable property to regulation for the first time, and the industry-wide penetration rate of only 60%, the telco regulatory approach of original cost based on its 95% penetration rate, maturity and, the financial stability borne of existence throughout most of this century, does not apply.

Cable operators, by virtue of distancing themselves from original cost calculations, are not trying to adjust the ratebase above the capital devoted to regulated service.[63/] Instead, the Joint Commenters only seek to ensure that the amount of capital is properly recognized, reflecting start-up losses and low earnings. A market value method helps establish these values. Unlike the regulated markets, where market value is the "result" of regulation, and not the starting point, the market values discussed here for cable were determined when cable systems were unregulated; acquisition costs were not the "result" of regulation or otherwise attributable to subscriber paid-in capital. Whether a particular transaction was prudent depends on a review of all information available at the time the transaction

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63/ BellSouth Comments at 23.

is consummated. When systems with acquisition costs were bought, the cable industry was not regulated. The price paid simply reflected the going market value. Operators should not be punished in hindsight for paying more than the cost of the first person to dedicate the tangible assets to cable service by artificially reducing rates and excluding acquisition costs from the ratebase.64/

As a result of the inadequacy of original cost as a valuation methodology, alternative methods of determining reasonable rates have developed. Because, furthermore, comparing expenses and operating revenues could provide a check on, and be a more accurate reflection of, the viability of a particular cable operator, an operating ratio analysis could be adopted to test rates.65/

64/ Predictably, the telcos repeat the argument advanced by the consumer groups that excess acquisition costs equal monopoly profits. BOC Joint Comments at 23; GTE Comments at 21. However, even in the regulated utility situation, acquisition premiums may be included "when the price of an asset is determined by an arms' length transaction in the normal course of business." In The Matter of Amendment of Part 65, 7 F.C.C. Rcd. at 299. The precedent disallowing inclusion of excess acquisition for the transfer of regulated entities has no relation to transactions involving unregulated entities prior to the establishment of a new regulatory regime.

65/ A company's operating ratio is the ratio of its operating expenses to operating revenues. When expenses equal revenues, the ratio is 100; as expenses exceed revenues, the number increases to over 100, and when revenues exceed expenses, the number is less than 100. Casco Bay Lines v. P.U.C., 390 A.2d 483, 490-91 (Me. 1978) (citing Maine Motor Rate Bureau, 357 A.2d 518, 521 n. 2 (Me. 1976)).

Regulatory bodies often have employed the operating ratio methodology when a utility's rate base does not permit it to generate a fair rate of return. See, e.g., Hamm v. South Carolina Pub. Serv. Comm'n, 422 S.E.2d 118, 122 (S.C. 1992) ("the operating ratio is particularly useful when a utility's rate base has been substantially reduced . . . "); State ex rel Util. Comm'n v. Public Staff, 343 S.E.2d 898, 901 (N.C. 1986) (the operating ratio methodology is appropriate when a company's level of original cost rate base is lower than its level of operating revenue deductions under present rates). Indeed, "it was the inevitable inadequacy of returns based on investment that . . . prompted the adoption of the operating ratio formula" in other industries. D.C. Transit Sys. v. Washington Metro. Area Trans. Comm'n, 350 F.2d 753, 759 (1965).66/

Obviously, no operator would stay in business and provide service to the public without a reasonable opportunity to earn a profit. In the circumstances where the rate base is very small, the operating ratio approach enables companies to have the

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66/ The Interstate Commerce Commission developed the operating ratio method of ratemaking during World War II in order to provide a fair test of revenue needs for the motor carrier industry in which, much like the cable industry, the tangible asset ratebase is small in comparison to total capital committed and costs. D.C. Transit Sys., 350 F.2d at 759. Today, operating ratios are often used to set rates for transit utilities where operating revenues and expenses are a more significant factor than original depreciated investment. Casco Bay Lines, 390 A.2d at 491 n. 4.

opportunity to earn enough profit to make it worthwhile to stay in business and assume the associated risks.

VI. OTHER ISSUES

A. Operating Expenses & Programming Costs

The Commission suggested that certain expenses might be automatically disallowed for rate making purposes.[67/] Many of the expenses catalogued for exclusion in fact are appropriate for inclusion as part of the calculation of the revenue requirements. Unlike public utility companies, cable television operators do not enjoy near-100% penetration and also experience marketing and other costs to attract and retain a stable subscriber base. Also, unlike public utility companies, cable operators must frequently renew their franchises (in order to retain their right to do business), provide community-based programming, and strive to deliver programming content responsive to community needs. Thus, charitable expenses, club fees and other money expended within the franchise community should be allowed as a necessary operating expense in fulfilling the quite different role of cable television.[68/]

67/ NPRM ¶ 24, n.25.

68/ The costs incurred in maintaining relations with the government and regulators are also recoverable. In particular, preparing and presenting information for regulatory purposes and cost-of-service filings are an allocable expense under Part 32. 47 C.F.R. § 32.6722.

Moreover, programming expenses would be very difficult to consider as a capital expense. They should, however, be allowed as a recoverable operating expense with an appropriate markup to allow the incentive to deploy additional programming services, without the risk associated with a regulatory lag that produces a loss over time, because rates are set on historical costs which inevitably rise.

B. Productivity Offset and Sharing

The productivity offset proposed by the telcos, consumer groups and franchising authorities is wrong for the reasons previously detailed in our initial comments.[69/] There was a long history of increasing telco productivity on which the price cap productivity was based.[70/] There is absolutely no such history for cable. The increases in telco productivity in the past years can reasonably be attributed, in part, to the growing competition they have been facing since divestiture. Competition has forced the telcos for the first time to restructure to generate operational efficiencies. Cable, on the other hand, has had always to face competition and its accumulated losses incurred to date demonstrate that fact. The notion, therefore, that there can be

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69/ Initial Comments at 91-92.

70/ Policy and Rules Concerning Rates for Dominant Carriers, 4 F.C.C. Rcd. 2873, 2989 (1989).

future improvements, year after year, simply does not follow.[71/]

The telcos also argue that cable will experience growth in subscribers and, therefore, continuing economies of scale. The data do not show that the high growth of the 1980 - 1992 period will continue and, actually demonstrates the contrary. An analysis of Table I to the Townsend Declaration,[72/] demonstrates that the average increase from 1980 to 1984 was approximately 4 million subscribers per-year, whereas the average increase for the next five years was only slightly more than 1.5 million for each year. This slow growth rate reflects the fact that more than 90% of the television households are now passed by cable and that the penetration rate is growing at a compound rate of less than 1% per year. In contrast, the percentage growth in telco access lines and interstate access minutes exceeds cable's growth significantly.[73/] Accordingly, no productivity offset at all is

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71/ Moreover the telco statistics demonstrate a much greater inefficiency in that they have a much higher number of employees per access line than cable. For instance, each Bell Atlantic employee covers 242.6 access lines while Southwestern Bell employees cover only 204 access lines each. KBLCOM, on the other hand, is almost twice as efficient, with each employee covering 381.4 subscribers. See Houston Industries' 1992 10-K; Bell Atlantic Corp., 1992 Annual Report, pursuant to Section 13 or 15(D) of the Securities Exchange Act of 1934, 19 (1993); Southwestern Bell Corp., 1992 Annual Report, pursuant to Section 13 or 15(D) of the Securities Exchange Act of 1934, 16 (1993); Study Area Detail for All Exchange Carriers: Pre-Subscribed Lines as of Dec. 31, 1992 (F.C.C. filing, 1993).

72/ Declaration of Robert L. Townsend, Director, Bell Atlantic Video Services, attached to Joint BOC Comments.

73/ In contrast, total telco access lines have grown more than three times the rate of cable penetration increases in

[Footnote continued]

merited for cable based on the telco analysis.

It also has been suggested that in addition to the productivity offset, cable should be subject to "sharing" profits as telcos do under price caps.[74/] AT&T, also operating under price caps like the LECs, has no sharing obligations. The rationale for allowing AT&T to avoid sharing, but imposing a sharing obligation on the LECs, involves (a) the lesser degree of competition that the LECs face compared to AT&T, as well as (b) a lack of knowledge about what the proper sharing should be for AT&T.[75/] Not only have we demonstrated that the particular productivity offset has no basis for cable, there has been no study performed over any period of time which could allow for its calculation. Finally, cable is subject to at least as much competition in the provision of video services as AT&T was for long distance services in 1988 when its price cap system was established, thus meriting no productivity offset or sharing for cable.

[Footnote continued]

recent years, with exceptionally higher growth since 1985. While there are slightly more than 90 million cable television households, with 54 million cable subscribers, growth has slowed perceptibly, to slightly less than 1 percent. On the other hand, total telco access lines have increased more than 30 million since 1983, for a total of 143 million access lines in 1992, a rate of almost 30%, with annual growth since 1988 of approximately 3%. Statistics of the Local Exchange Carriers, United States Tel. Ass'n 2 (Sept. 1993).

74/ BOC Comments at 10.

75/ Policy and Rules Concerning Rates for Dominant Carriers, 4 F.C.C. Rcd. 2873, 3148-9 (1989).

C. Cost Allocation

In our Initial Comments, we discussed cost allocation rules for cable which should be flexible to allow for subscriber, revenue or weighted subscriber allocations, depending on the circumstances of the particular expense. However, applying existing cost allocation rules developed for telcos would be irrational. The LECs offered almost exclusively regulated services for one hundred years. Gradually, individual aspects of the telco business became unregulated, requiring rules to be developed to prevent the inflation of a massive regulated revenue stream to cover losses of unregulated activities, or other misuse, and allow harm to competitors in unregulated markets. This logic does not apply to cable.

Cable has been unregulated since its inception and is still in its "start-up" phase as a business. Telephone companies have not had to be concerned about "start-up costs" since Theodore Roosevelt was President. Cable does not have the financial luxury of wasting money from its core business to subsidize other, non-regulated businesses. Indeed, as recognized by the Commission's proposal to allow cost-of-service showings, cable is more in jeopardy of not being able to recover the costs of its core business at all.

D. Depreciation

It also has been argued that the depreciation rates for cable and telephone companies should be identical. We addressed this issue in detail in our initial comments. First, there is no requirement that the Commission prescribe depreciation rates at all for cable, as is expressly required for telephone companies under the Communications Act.[76/] Moreover, the telephone companies have a long history of deployment of different generations of technologies on which to base depreciation prescriptions. No such history exists for cable.

Also, as set forth in the discussion concerning the proposed "regulatory parity", cable and telephone technologies are not really the same. The telcos have argued that because of the deployment of the same technologies there is every reason to apply the same depreciation rules.[77/] However, if two businesses use an identical truck, but one business drives its truck 200,000 miles per year, and the other business drives its truck only 10,000 miles per year, it would make no sense to require both businesses to depreciate the truck over the same period. Plant configuration, technologies, service provision, and almost every other aspect of cable service is different from telephone except for the provision of electrical impulses over a wire. However,

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76/ Compare 47 U.S.C. § 220(B) with 47 U.S.C. 623.

77/ BOC Comments at 21.

it has not been suggested that the rules of depreciation for electric utilities be applied to cable or telco because such an approach would not recognize the inherent differences in the product and service being offered.

E. Streamlining

Some commenters suggest that cost-of-service principles can be developed on a case-by-case basis. However, if any federal scheme of regulation will work, it is crucial that the Commission resolve the key substantive elements of the ratebase, the authorized return, and the allowance of operating and programming expenses. Without that, there will be a significant possibility that more than 30,000 franchising authorities will find inconsistent and incompatible rules (even for integrated systems), and set rates arbitrarily without due regard of cable's unique operational structure.

In order to avoid this result, the Commission should also consider seriously the streamlining proposals offered in the initial comments. This will greatly ease the burden at both federal and local levels and permit recognition of various capital elements which are not reflected in the existing benchmarks. It also would minimize the number of rate cases and stabilize rates.

CONCLUSION

A number of commenters adopted the theme of making the regulatory process difficult and untenable for cable operators. While the unintended result of the 1992 Cable Act is to make regulation of cable operators more complex, the Commission can simplify the process greatly, provide uniform guidelines, and allow for cost recovery by affected cable operators. For many systems, it is expected that competition will soon be effective to the point of eliminating the need for detailed rate review. In the interim, however, the Commission must be sure to properly guard the interests of the investors when balancing subscribers' interest in lower rates.

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September 14, 1993

EXHIBIT A

FRANCHISE RENEWAL WITH REBUILD REQUIREMENTS
BENCHMARK APPROACH

The attached example demonstrates that in the situation of a recently acquired system, with modest debt associated with goodwill and franchise obligations, the ability to generate reasonable returns is deferred until the time that debt burdens are reduced and if fortunate, subscribership increases.

If additional obligations are levied on the operator such as through a renewed franchise agreement, the ability to earn a return is delayed even further. Modest rate increases may be able to mitigate some of this delay; however, under the benchmark scheme, the ability to earn a return is dismal, short of dramatic increases in subscribership.

This example illustrates using typical, if not conservative, estimates of costs and revenues, the likely financial results for a recently acquired system of 250 thousand subscribers over a fifteen year operating period. In the base case, the benchmark rate is initialized in 1994 and escalates at 4% per year. Operating expenses also increase with this rate of inflation. Programming costs escalate each year at 5%. Other expenses include depreciation, and amortization of goodwill and franchise costs paid at acquisition and funded with a 50/50 ratio of debt to equity. Minimal periodic additions of $10 million a year are included. As the base case illustrates, under the benchmark approach and without substantial increases in subscribership, the operator is slow to earn a reasonable return.

Under the next example, the franchise authority requires the operator to invest in system upgrades totalling $24 million a year for the five years 1995 to 1999. All other assumptions are consistent with the base case. It is evident that the additional burden placed on the operator under the benchmark rate approach, provides no relief. A positive return will not be forthcoming for quite some time. The benchmark mechanism without some adjustment simply will not provide a means to recover increases in costs which exceed some minimal inflation factor. This will have the quite obvious effect of limiting the operators ability to enhance services and compete for the customer's entertainment dollar.

9/8/93 FRANCHISE RENEWAL WITH AND WITHOUT REBUILD REQUIREMENTS

ASSUMPTIONS:

Renew franchise in 1995; new period extends to 2010
250,000 subscribers
Cost of sales to escalate at 5% per year
Annual additions excl. rebuild of $10M a year
40 channels, 25 satellites which results in a benchmark rate of $.549 per channel per sub

50/50 capitalization structure
Debt cost of 8% per year
Current penetration of 50% escalating 1/2% per year.
Revenues includes all services; regulated and unregulated.
Initial investment in system of $370 million

BASE CASE FRANCHISE WITHOUT REBUILD REQUIREMENT

(000'S)

YEAR	REVENUES	COST OF SALES	OPERATING EXPENSES	OPERATING INCOME	NON-OPER. EXPENSES(1)	TAXES(2)	NET INCOME	RETURN ON INVESTMENT
1994	$80,000	$17,600	$22,400	$40,000	$34,480	$1,932	$3,588	
1995	83,616	18,572	23,296	41,748	34,060	2,691	4,997	
1996	87,571	19,599	24,228	43,745	34,640	3,187	5,918	
1997	91,715	20,681	25,197	45,837	35,180	3,730	6,927	
1998	96,057	21,824	26,205	48,028	35,680	4,322	8,026	
1999	100,606	23,030	27,253	50,323	36,140	4,964	9,219	
2000	105,371	24,302	28,343	52,726	36,560	5,658	10,508	
2001	110,364	25,645	29,477	55,242	36,940	6,406	11,897	
2002	115,596	27,062	30,656	57,878	37,280	7,209	13,389	
2003	121,077	28,557	31,882	60,638	37,580	8,070	14,988	
2004	126,820	30,135	33,157	63,528	37,840	8,991	16,697	
2005	132,838	31,800	34,484	66,555	38,060	9,973	18,522	
2006	139,144	33,557	35,863	69,724	38,240	11,019	20,465	
2007	145,751	35,411	37,298	73,043	38,380	12,132	22,531	
2008	152,675	37,367	38,790	76,518	38,480	13,313	24,725	
2009	159,930	39,431	40,341	80,157	38,540	14,566	27,051	
2010	167,532	41,610	41,955	83,967	38,560	15,893	29,515	2.65%

NOTES:

(1) Depreciation and amortization plus interest expense
(2) Operating income less depreciation expense, interest expense, and amortization of franchise and goodwill times 35%
(3) Based on the initial equity investment of $185M (50% of $370M)

BASE CASE	PLANT ACCOUNTS, DEPRECIATION AND AMORTIZATION WITHOUT REBUILD									
YEAR	FIXED ASSET BAL(1)	ACC. DEPRE	NET BALANCE	DEPRECIATION EXPENSE(2)	FRANCHISE	AMORT. OF FRANCHISE(3)	NET FRANCHISE	GOODWILL	AMORT. OF GOODWILL(4)	NET GOODWILL
1994	$120,000	$12,000	$108,000	$12,000	$100,000	$2,500	$97,500	$150,000	$6,000	$144,000
1995	130,000	24,000	106,000	$12,000		$2,500	95,000		6,000	138,000
1996	140,000	36,000	104,000	$13,000		$2,500	92,500		6,000	132,000
1997	150,000	49,000	101,000	$14,000		$2,500	90,000		6,000	126,000
1998	160,000	63,000	97,000	$15,000		$2,500	87,500		6,000	120,000
1999	170,000	78,000	92,000	$16,000		$2,500	85,000		6,000	114,000
2000	180,000	94,000	86,000	$17,000		$2,500	82,500		6,000	108,000
2001	190,000	111,000	79,000	$18,000		$2,500	80,000		6,000	102,000
2002	200,000	129,000	71,000	$19,000		$2,500	77,500		6,000	96,000
2003	210,000	148,000	62,000	$20,000		$2,500	75,000		6,000	90,000
2004	220,000	168,000	52,000	$21,000		$2,500	72,500		6,000	84,000
2005	230,000	189,000	41,000	$22,000		$2,500	70,000		6,000	78,000
2006	240,000	211,000	29,000	$23,000		$2,500	67,500		6,000	72,000
2007	250,000	234,000	16,000	$24,000		$2,500	65,000		6,000	66,000
2008	260,000	258,000	2,000	$25,000		$2,500	62,500		6,000	60,000
2009	270,000	283,000	(13,000)	$26,000		$2,500	60,000		6,000	54,000
2010	280,000	309,000	(29,000)	$27,000		$2,500	57,500		6,000	48,000

NOTES:

(1) $10M per year in additions
(2) Depreciation rate of 10%
(3) Amortization of franchise over 40 years
(4) Amortization of goodwill over 25 years

BASE CASE		INTEREST EXPENSE		
YEAR	NET PLANT	NET FRANCHISE	NET GOODWILL	INTEREST EXPENSE
	(1)	(2)	(3)	(4)
1994	$108,000	$97,500	$144,000	$13,980
1995	106,000	95,000	138,000	13,560
1996	104,000	92,500	132,000	13,140
1997	101,000	90,000	126,000	12,680
1998	97,000	87,500	120,000	12,180
1999	92,000	85,000	114,000	11,640
2000	86,000	82,500	108,000	11,060
2001	79,000	80,000	102,000	10,440
2002	71,000	77,500	96,000	9,780
2003	62,000	75,000	90,000	9,080
2004	52,000	72,500	84,000	8,340
2005	41,000	70,000	78,000	7,560
2006	29,000	67,500	72,000	6,740
2007	16,000	65,000	66,000	5,880
2008	2,000	62,500	60,000	4,980
2009	(13,000)	60,000	54,000	4,040
2010	(29,000)	57,500	48,000	3,060

NOTES:
(4) Columns (1)+(2)+(3) times 50% times 8% debt cost.

FRANCHISE WITH REBUILD REQUIREMENT

YEAR	REVENUES	COST OF SALES	OPERATING EXPENSES	OPERATING INCOME	NON-OPER. EXPENSES	TAXES	NET INCOME	RETURN ON INVESTMENT
1994	$80,000	$17,600	$22,400	$40,000	$34,480	$1,932	$3,588	
1995	83,616	18,572	23,296	41,748	35,020	2,355	4,373	
1996	87,571	19,599	24,228	43,745	38,960	1,675	3,110	
1997	91,715	20,681	25,197	45,837	42,764	1,076	1,998	
1998	96,057	21,824	26,205	48,028	46,432	559	1,037	
1999	100,606	23,030	27,253	50,323	49,964	126	233	
2000	105,371	24,302	28,343	52,726	52,400	114	212	
2001	110,364	25,645	29,477	55,242	52,300	1,030	1,913	
2002	115,596	27,062	30,656	57,878	52,160	2,001	3,717	
2003	121,077	28,557	31,882	60,638	51,980	3,030	5,628	
2004	126,820	30,135	33,157	63,528	51,760	4,119	7,649	
2005	132,838	31,800	34,484	66,555	51,500	5,269	9,786	
2006	139,144	33,557	35,863	69,724	51,200	6,483	12,041	
2007	145,751	35,411	37,298	73,043	50,860	7,764	14,419	
2008	152,675	37,367	38,790	76,518	50,480	9,113	16,925	
2009	159,930	39,431	40,341	80,157	50,060	10,534	19,563	
2010	167,532	41,610	41,955	83,967	49,600	12,029	22,339	-2.75%

NOTES:

Franchise requires rebuild expenditures of $24M per year for 5 years.